The Verizon-Frontier Deal Does Not Meet the FCC's Public Interest Standard

THE PROPOSED DEAL DOES NOT MEET THE FCC's PUBLIC INTEREST STANDARD. The FCC has jurisdiction to approve the deal as proposed, deny the deal, or approve it with conditions. The FCC must decide whether the deal will serve the public interest which includes among other things the preservation and advancement of universal service, the accelerated deployment of advanced services and whether the merger will affect the quality of communications services. In its evaluation, the Commission must consider whether the new entity will have the requisite financial, technical and other qualifications to meet the public interest. The CWA and IBEW have argued that an analysis of the facts – not company promises or intent – clearly indicates that deal does not meet the FCC's public interest standard.

- **Frontier Will Be an Impediment to the FCC's Broadband Goals.** If approved, the proposed deal would seriously hinder achieving the FCC's new National Broadband Plan. The FCC has set a national goal of a minimum broadband speed of 4 megabits per second with at least 100 million households having access to 50 megabits per second service by 2015. Frontier's commitments fall far short of these goals.
    - Ohio: 85% of households will be able to access broadband at speeds of at least 1 mbps by the end of 2013.
    - Oregon: 60% of households will obtain a minimum of 3 mbps in currently un-served wire centers by mid-2013 but Frontier can petition for a slower speed.
    - Washington: In a staff settlement (not yet approved), Frontier committed to deploy broadband 3 mbps to 80% of households by year-end 2014.
    - Illinois: In a staff settlement (not yet approved), Frontier agreed to deploy 1.5 mbps to 85% of household by year-end 2013.
    - No broadband commitments made in Arizona, California, Idaho, Indiana, Michigan, North Carolina, South Carolina and Wisconsin.
    - Frontier has no plans to expand beyond Verizon's existing commitments the higher-speed "fiber-to-the-home" service that Verizon currently provides in portions of four states Frontier wants to acquire (Indiana, Oregon, South Carolina, and Washington).

  The bottom line is that West Virginia and the other states will have no chance to have a high-speed broadband network with Frontier. Furthermore, the lack of such a high-speed network will adversely affect the economies and competitiveness of the affected states.

- **Frontier is not financially fit to own and operate the properties it will acquire from Verizon.** Frontier does not have the financial wherewithal to sustain operations that would triple its size.
    - Frontier does not have an investment-grade bond rating, will take on an enormous debt burden of $3.3 billion and its revenue and net income have been in a steady state of decline.
    - The operations in the affected states will be financially weaker after the transaction than before. Verizon has an investment-grade bond rating while Frontier does not have an investment-grade bond rating. On the day the transaction was announced, Moody's Investor's Service placed the debt of the

Verizon properties to be acquired by Frontier on review for a possible downgrade (Verizon North, Verizon Northwest and Verizon West Virginia).

- o Frontier's business model is unsustainable. Frontier pays out significantly more to stockholders than it earns in net income (profits). From 2004-08, Frontier paid out almost three times as much to stockholders as it earned in net income – almost $2 billion left the company. This policy will continue after the sale.
- o Frontier also pays out far more to stockholders than it reinvests in its infrastructure. During a four-year period from 2005 through 2008 Frontier made capital investments of $1.1 billion, but it paid stockholders more than $2.1 billion during that same time.
- o Frontier's management is "cannibalizing" the company – Frontier's shareholders' equity declined from $2.1 billion at year-end 2001 to only $339 million at year-end 2009. Similarly, Frontier's net investment in property, plant and equipment declined from $4.5 billion in 2001 to $3.1 billion at year-end 2009. This pattern will not change after the transaction. Frontier is quite literally devouring itself – returning far more to shareholders than Frontier is able to earn using shareholders' equity investment in the company.

- **Diminished Service Quality and the Risks of Systems Integration.** Frontier's lack of financial soundness will place the company under tremendous pressure to try to meet the expectations of Wall Street lenders, so that Frontier can service the more than $3 billion in debt it will issue.
  - o Frontier has promised Wall Street that it will be able to cut Verizon's annual operating expenses by $500 million in less than three years – an unprecedented level of cost reductions that would require Frontier to drastically reduce the size of its workforce.
  - o The combination of financial pressures and drastic cuts in employment are likely to adversely affect the timeliness and quality of Frontier's installation, maintenance, and repair activities.
  - o Frontier has not conducted adequate on-site inspections to determine the actual condition of Verizon's infrastructure and thus cannot adequately determine the cost of meeting service quality standards in the different states.
  - o Just in the last couple of weeks – 10 months after they signed the deal – Frontier "discovered" that Verizon had 300 lines in Virginia that are served out of West Virginia, so it now must seek regulatory approval in Virginia. This is just one indication of Frontier's lack of due diligence in its evaluation of Verizon's assets.
  - o Frontier's track record in previous acquisitions raises further concerns. Frontier's performance in its largest operation, Rochester Telephone, showed a significant deterioration in service quality in 2007 and 2008. Frontier's two most recent acquisitions – Global Valley and Commonwealth in 2007 – exhibited serious service quality concerns after Frontier assumed control.
  - o Frontier must undertake the very complex process of integrating Verizon's 156 different systems.
  - o Frontier must integrate West Virginia's systems on Day One – something that has never been done with former Bell Atlantic systems.
  - o Frontier must pay Verizon $94 million a year until it integrates the systems in the 13 non-West Virginia states.
  - o Frontier had integration problems after it acquired Rochester Telephone. It took seven years for Frontier to integrate these systems and even then there were significant service quality problems.

- **Loss of Jobs.** Frontier's plan to cut annual operating expenses by $500 million will mean a loss of jobs.
    - Frontier's CEO, Maggie Wilderotter, stated that "Frontier plans to cut jobs" as part of its effort to achieve cost savings of $500 million a year.
    - Frontier has a history of significantly reducing its workforce – especially after mergers.
    - A significant number of Verizon workers in the areas to be acquired will retire rather than risk their future with Frontier. Thus, Frontier will be faced with the added expenses associated with backfilling and training new workers.

- **Verizon has a Bad Track Record in Similar Deals.** Verizon has been involved in two other similar divestitures, Hawaiian Telcom and FairPoint (Maine, New Hampshire and Vermont).
    - Both divestitures have resulted in bankruptcy by the acquiring companies and a significant deterioration in customer service.
    - Each of the acquiring companies took on significant debt to fund the transaction – just like Frontier.
    - Just as in the Frontier deal, management of Hawaiian Telcom and FairPoint stated that the deals would improve their finances and promised to improve customer service and expand broadband.
    - Each of the acquiring companies failed to smoothly integrate Verizon's operating and billing systems even though they promised a smooth transition.

- **Consumers and Workers Will Bear Significantly Greater Risks with Frontier than Verizon.** There is no question that Frontier is a much weaker company and that Frontier is far less able to raise capital on reasonable terms than is Verizon. And that Frontier will have significantly fewer resources to expand broadband and improve customer service than Verizon.
    - Frontier will not only have to service $3.3 billion in additional debt but must also cut annual operating expenses by $500 million. This will significantly impair Frontier's ability to expand high speed broadband, improve service quality, and maintain jobs. Conversely, Verizon has the resources to enhance broadband and service quality.
    - Rather than bringing lower-cost debt to the acquired operations, Frontier's cost of debt is higher than Verizon's, and Frontier will be taking on $3.3 billion of additional debt in order to finance the proposed transaction.
    - Even significant financial conditions in Hawaii, Vermont, New Hampshire and Maine were not enough to prevent bankruptcies. The conditions related to service quality and broadband build-out proved ineffective in the face of operational problems and financial distress.
    - Verizon clearly agreed to this deal because it could avoid paying taxes on $3.3 billion, not because this deal is better for consumers or communities. Verizon was able to take advantage of a special tax loophole, the Reverse Morris Trust, because it selected a much smaller company like Frontier. Verizon chose to avoid taxes by selling to Frontier rather than open the transaction to larger companies with more resources.

THE COMMISSION SHOULD REJECT THE PROPOSED DEAL.

- **The risks – and harms – of the deal to consumers, workers and communities far outweigh any supposed benefits.**
    - Frontier would be an impediment to the FCC's national broadband goals.

- Frontier will not have the financial resources and stability to adequately address the needs of its consumers and communities.
- Service quality will be diminished and jobs will be lost.

- **Consumers and workers face far greater risks with Frontier than they would with Verizon.**
  - There is no question that Verizon is much less susceptible to financial and operational problems than Frontier.
  - Verizon has more resources to respond to changes in the economy and emergencies and more resources to devote to operations, service quality and broadband expansion.
  - The FCC and state commissions made the wrong decision when confronted with similar deals with FairPoint and Hawaiian Telcom.
  - Rejecting the deal doesn't mean Verizon will not invest in these properties. Verizon retains a fiduciary responsibility to its shareholders to maximize earnings from these properties. In upstate New York, Verizon tried to sell its rural lines but couldn't find a buyer. Since then, Verizon has invested almost $900 million in its most advanced high-speed Internet services in upstate New York.